

Order Instituting Rulemaking on the Commission's Own Motion to Evaluate Existing Practices and Policies for Processing General Rate Cases and to Revise the General Rate Case Plan for Class A Water Companies.

R.03-09-005

**REPLY COMMENTS OF THE OFFICE OF RATEPAYER
ADVOCATES ON COMMENTS TO THE DRAFT DECISION AND
WATER DIVISION WORKSHOP REPORT**

Pursuant to the schedule set forth in the Administrative Law Judge's ("ALJ") March 16, 2004 ruling, the Office of Ratepayer Advocates ("ORA") files its reply comments on parties' comments on the Draft Decision ("DD") and March 22, 2004 Workshop Report issued in the above captioned proceeding.

**I. IN THE ALTERNATIVE, ORA RECOMMENDS THAT THE
COMMISSION RETAIN THE CURRENT PROCESS OF TWO
TEST YEARS AND ONE ATTRITION YEAR FOR CAPITAL
ADDITIONS**

At the April 8, 2004 oral argument, the ALJ proposed a new method for handling capital additions in the rate case plan. As ORA understands it, under the ALJ's proposal, the utilities would file a one-year capital budget for the test year in their general rate case ("GRC") applications. There would be no distinction made between major and routine capital additions. The entire capital budget would then be inflated by an appropriate factor to derive the amount that goes into building revenue requirement for the escalation years. ORA would then be required to do a retrospective reasonableness review of all the capital additions that have been done in the three years prior to the next GRC. ORA would have to

look retrospectively to see what the utility did, how it spent the money, and if it was reasonable. If ORA determined an expenditure was imprudent, the amount would be disallowed on a going forward basis. The utilities' escalation year increases would be subject to an earnings test in the escalation years as well.

ORA has a number of concerns with this proposal. While having a one-year capital budget for the test year and escalating that amount for years two and three appears to simplify the GRC process, this structure could lead to perverse incentives. Because the utilities would not be able to specify major projects in years two and three, they would have an incentive to pack as much into the test year as possible. Because the test year estimate will serve as the basis for the two escalation years, the utilities will want the test year to be the highest possible amount.

Problems also arise in the case where the budget for the test year includes projects that occur in the test year only, and years two and three require a reduced level of major capital additions. For example, in California Water Service Company's ("Cal Water") Bakersfield district GRC (A.03-10-021) the total capital budgets for transition year 2003 and test years 2004 and 2005 are:

2003 - \$11,939,400
2004 - \$10,661,900, decreased by 10.7%
2005 - \$ 8,555,600, decreased by 19.8%

To automatically escalate the entire capital additions budget by a water plant index ("WPI") or any index could drastically overstate the amount actually needed. Less likely, but still possible would be the opposite situation where the test year estimate for capital additions is abnormally low and actual needs for the two escalation years are much higher. This approach would then underestimate what is actually needed.

As Mr. Mattes stated during the Oral Argument:

The problem with that is the lumpiness of capital-investment projects; that -- especially when you know we've tried to take the predictable flow of projects, and

deal with that in a routine way by the category of routine projects, but the major projects are the lumpy part.

And for a particular company, they may be facing a major growth situation or an aging of plant or some kind of problem that may not be quite the natural disaster that justifies creating a memorandum account, but some event that requires them to make an unusual level of capital investments; or conversely, they may have just done that two years before, and now they're - they're on easy street for a couple of years. And you wouldn't want to give them a full allowance for major projects. (Reporter's Transcript, pp. 16-17)

Another risk is that projects approved for the test year could get delayed and not be completed in the test year. In the past, ORA has recommended certain projects originally proposed for the test year be deferred to the next year. For example, ORA recommended deferring projects from the test year to subsequent years in Southern California Water Company's ("SCWC") Metropolitan customer service area GRC in A.03-10-006. SCWC agreed to most of these recommendations.

Furthermore, there is a risk that plant additions in the escalation years might not be built at all. This creates the potential that the utility could collect a rate of return on phantom rate base until the next GRC.

If ORA recommends a disallowance and a reduction in recorded plant in the next GRC retrospective review, the adjustment will only be reflected prospectively, in the test year. The utility will have already collected revenue in the recorded year based on plant that was not built. ORA cannot make recommendations to reduce recorded year revenue. For example, if ORA was reviewing the 2003 recorded year and recommended a reduction in plant from \$10 million to \$8 million, the \$2 million disallowance would be reflected in plant in the 2004 test year and carried forward, but no revenue associated with the unbuilt plant in 2003 would be adjusted.

Finally, the utilities may have an incentive to build plant even if it is not needed, just to have the money spent. The threshold for determining whether a plant expenditure is imprudent retrospectively and recommending it be disallowed is no doubt higher than recommending a proposed addition not be authorized beforehand as is done currently in the GRCs. It likely would be harder for the Commission to disallow these types of expenditures after the fact.

At the oral argument, the ALJ asked ORA to address “what ORA would require to enable efficient review, after the fact, for reasonableness purposes, [of] capital investments over the previous . . . three years.” (Reporter’s Transcript, p. 27.) Doing a three-year comprehensive retrospective review in each GRC would significantly add to ORA’s the workload. In fact, evaluating one test year and doing a retrospective review of the past three years of capital projects would be *more* work than evaluating a two-year capital budget as is done now and then having an attrition year.

Doing a three-year retrospective review of capital projects is not the same thing ORA does now in GRCs. Under the ALJ’s proposal, ORA would be reviewing capital projects from the two escalation years. ORA would not be able to determine why each plant addition was needed, whether it was reasonable, or the basis for those additions because there will not be a specific capital budget authorized for the escalation years in the previous GRC. It will be difficult to review the reasonableness because ORA will see primarily just numbers: what has been recorded in plant, depreciation reserve, advances, contribution in rate base and related items. Because the prior GRC decision will have only adopted specific projects for the one test year, the only thing immediately available for comparison would be the escalation year authorized amount. To properly review these numbers, and to do more than just assuring plant was built, ORA will need to prepare data requests asking the utilities to provide work papers, invoices and supporting data to justify the additions, which may be comprised of many projects.

This, in essence, is like reviewing a four-year capital budget: three recorded years and one test year.

If the utility recorded more than was authorized in the escalation year, ORA will have no basis for what should be excluded because no specific projects were authorized. ORA will not be able to make any recommendations on plant over built. If the utility recorded less than authorized in the escalation years, ORA will not be able to determine what was not included without specific capital budget items.

The utility alternative of having a three-year capital budget in addition to a three-year retrospective review runs counter to the goal of simplification. Having major capital additions reviewed in advance and authorized in each GRC would at least make a retrospective review more effective and somewhat less work, but it would still exceed the current workload and increase the complexity of the GRC.

ORA notes the comments made by San Gabriel Water Company (“San Gabriel”) when it stated in its opening comments that two test years and one attrition year has worked well over the years and should not be hastily discarded. (San Gabriel Comments, p. 7.) ORA urges the Commission to keep this traditional approach for evaluating capital additions in the GRCs instead of adopting either a one year capital budget and escalating it, or adopting the utilities’ three year capital budget proposal. The current approach that retains two test years and one attrition year for capital additions is actually the most streamlined and effective approach for capital additions considered yet.

ORA notes that on the whole, the proposed rate case plan has been substantially simplified over the current plan by eliminating one test year for expenses and revenues. The workshop consensus recommendations will lead to further streamlining of expenses by adopting standardized approaches to forecasting customers, consumption, and expenses. These are important steps forward and ORA recommends the Commission adopt these consensus recommendations. However, if the Commission adopts a proposal escalating plant

and doing a three-year retrospective review it will likely prove to be onerous and could potentially wipe out the significant gains achieved in simplifying the process for reviewing revenues and expenses. If the Commission retains the current two test years and one attrition year for plant, it would be simpler than either of the proposals considered above for handling capital additions. First, there would be no need to make a distinction between routine and major capital additions. Second, there would be no need for the development of the water plant index as the amount that goes into building revenue requirement for each year would be authorized in the GRC decision for the first two (test) years, and the third year could be handled as it is now in the attrition year. This would also simplify the job of Water Division (“WD”) during the escalation years, as the exact numbers would be specified in advance in the GRC decision. There would be no need to apply the most recent WPI to come up with the new amount. Moreover, ORA, WD, and utility staff are already familiar with this procedure and would need no retraining.

If the Commission does not adopt either of ORA’s proposals for capital additions as delineated in ORA’s Opening Comments, ORA urges the Commission to retain the current two test years and one attrition year for evaluating capital additions in the new rate case plan.

II. ALLOCATING GENERAL OFFICE COSTS TO DISTRICTS OUTSIDE OF THE RATE CASE CYCLE WILL LIKELY CAUSE CUSTOMER CONFUSION.

Under the current rate case plan, customers receive one customer notice that covers rate increases for the whole three-year rate case cycle. Under the current rate case plan, general office (“GO”) allocations are applied only to those ratemaking districts that have come in for their GRC's, and not to all the utility ratemaking districts at the time the Commission adopts the GO allocations. If the utilities were to allocate the adopted GO revenue requirement to all the utilities’ ratemaking districts at the time the Commission adopts the GO allocations,

customers from the non-GRC districts would need to receive notice of the potential increase in rates due to the GO allocations. This would mean customers in the non-GRC ratemaking districts would receive a notice of a rate increase during a non-GRC year in addition to the standard notice they receive during the GRC for their district.

Normally, when customers receive notice of a utility's proposal for a rate increase during the GRC, they have an opportunity to protest. Customers may voice their opinions during public participation hearings, which are held before or during the test year. In order to give customers the opportunity to protest the rate increase due to general office allocations in a non-GRC ratemaking district, notice would have to be sent out to all customers in a multi-districts utility in advance, giving them the opportunity to protest as well. It is likely that this additional notice will generate customer confusion and additional protests. It is also likely that ORA or the Consumer Affairs Branch would receive complaints from customers in the non-GRC districts as well GRC districts. Customers may not understand why they are receiving another notice of a rate increase just a year or two after the typical GRC notice they usually receive. The additional GO notices will not only create additional work for the utilities, but also more confusion for customers and additional customer notice related expenses that customers will have to absorb.

III. ORA AND THE COMMISSION ARE ENTITLED TO RECEIVE AND USE UPDATED INFORMATION

San Jose Water Company ("SJWC") and the California Water Association ("CWA") argue that ORA should not be allowed to request or use updated historical information after the utilities file their applications. (SJWC Comments, p. 3, CWA Comments, p. 13.) The Commission should reject this recommendation. ORA and the Commission are entitled to request this data. Public Utilities Code ("P.U. Code") § 309.5 empowers ORA to compel the production or disclosure, from entities regulated by the Commission, of any

information it deems necessary to perform its duties. P.U. Code § 314 authorizes the Commission and its staff to inspect the accounts, books, papers, and documents of any public utility at any time. Denying ORA this updated information effectively denies the Commission the right to review and consider this information contrary to the Commission's rights pursuant to the P.U. Code.

ORA is not scheduled to submit its analyses and recommendations until three to four months after the utilities file their application, and it makes no sense to require ORA or the Commission to ignore this more current information. The Commission is entitled to consider the most recent information available when it reviews the utilities' rate adjustment requests. The Commission should reject SJWC's and CWA's request

IV. REQUIREMENTS FOR UTILITY WORKPAPERS SHOULD NOT APPLY TO ORA WORKPAPERS

SJWC argues that the Commission should require ORA's workpapers to meet all of the same requirements that the utilities' workpapers must meet as provided in the rate case plan. (SJWC's Comments, pp.3-4). SJWC seems to forget that it is the utility that has the burden to prove that its requested rate relief is justified and fully documented. ORA is merely reviewing the utilities' requests. The utilities have more staff available than ORA to prepare their workpapers and their staff has detailed knowledge about the utilities' operations. While the utilities have years to prepare for their next rate case, ORA has only a few months to review the utilities' applications and make the appropriate adjustments. In addition, while ORA is working on SJWC's rate case, ORA will also be working on rate cases for three other utilities.¹ SJWC's recommendation seems to be aimed at reducing the amount of review that ORA staff can conduct because if ORA was held to the same standards for its workpapers, it would take time away

¹ When SJWC files its rate case in 2006, ORA staff will also be processing rate cases for So Cal, Cal-Am, and Park.. (DD Appendix, p. 16.)

from reviewing other areas of the utilities' application. The Commission should reject SJWC's recommendation. If a utility has problems with ORA's workpapers it can send ORA data requests or cross-examine ORA staff during hearings.

V. ORA IS CURRENTLY REVIEWING THE MASTER DATA REQUEST

California-America Water Company ("Cal-Am") requests that the Commission revamp the MDR as part of Phase II of this proceeding. (Cal-Am Comments. 12.) While ORA agrees that the current MDR is outdated, it is unnecessary and inappropriate to revamp the MDR as part of workshops in Phase II. ORA is already in the process of reviewing and revising the MDR. ORA hopes to have a new MDR ready for the July 2004 filers. As previously stated, pursuant to P.U. Code § 309.5 ORA has right to compel the production or disclosure of any information it deems necessary to perform its duties. The Commission should not place utilities in a position to decide what ORA can or cannot ask a utility during a GRC by including the MDR as an issue in Phase II workshops. The MDR is an ORA data request and what ORA can or should request of the utilities is a matter for ORA to decide.

VI. ORA STAFF IS NOT AVAILABLE TO PROCESS SCWC'S REGION I RATE CASE AT THIS TIME.

SCWC requests that the ALJ issue an order allowing SCWC to file its GRC for Region I immediately. (SCWC Comments, p. 3.) ORA opposes this request. The ALJ's November 26, 2003 Ruling ("November Ruling") adopted ORA's proposal to defer January 2004 filers. (November Ruling, p. 4.) As SCWC notes, the DD defers SCWC's filing until January 2007 rather than by one year as originally anticipated. SCWC argues that because Cal-Am met with the ALJ and received permission to file its GRC, SCWC should similarly receive such

permissions.² (*Ibid.*) SCWC states that while it tried to tender its rate case filing in January 2004, ORA rejected it and would not allow the Docket Office to file the application. (*Ibid.*) ORA notes that Commission Decision 02-12-068 ordered Cal-Am to file its rate cases as scheduled for identified districts (D.02-12-068, Appendix B, p. 3.) and thus ORA did not reject these applications. However, there is no decision ordering SCWC to file its applications and there is an ALJ Ruling ordering SCWC not file its applications. ORA had no choice but to reject SCWC's applications.

SCWC now seeks permission to file its rate case immediately. The problem, however, is that if SCWC files its application now, it will affect ORA staffing and processing of all future rate cases. If ORA immediately has to staff SCWC's rate case, it would have to use staff that will be assigned to rate cases that are scheduled to be filed in July 2004 and would be unable to staff and process all of the July 2004 filed rate cases. Inserting SCWC's application into the proposed rate case schedule creates a "domino effect", and staffing problems would continue for rate cases filed thereafter. ORA would not oppose processing SCWC's rate case application in January 2005 if the schedule at page 16 of the draft decision is modified to reduce the number of filers scheduled for January 2005 and beyond.³

As ORA noted in its November 4, 2003 reply comments, ORA is willing to work with SCWC to propose a rate escalation process based on the consumer price index.

² ORA notes that the ALJ denied granting such a request at the April 8, 2004 Oral Argument in this proceeding. (Reporters Transcript, p. 69.)

³ ORA would not be able to process 17 district rate cases in January 2005 if SCWC was permitted to file in January 2005.

VII. ORA DOES NOT OBJECT TO CAL WATER’S PROPOSAL TO FILE ADDITIONAL ATTRITION INCREASES FOR DISTRICTS OUTSIDE THE THREE YEAR RATE CASE CYCLE IF THE FILINGS ARE CONDITIONED UPON AN EARNINGS TEST

Cal Water requests that the Commission authorize it to file additional attrition increases for the districts that will be outside the three-year rate case cycle because of the limitation that utilities can file no more than eight districts in any given year. ORA does not object to this request if the attrition request is subject to an earnings test. While ORA notes that there are flaws in the earnings tests, ORA will accept such test here for the limited purpose of getting Cal Water on schedule to file eight districts a year and meeting the three-year rate case cycle.

VIII. ORA OPPOSES LENGTHENING TIME FOR UTILITY REBUTTAL TESTIMONY AND BRIEFS.

San Gabriel proposes extending the rate case schedule to allow the utilities 30 days to prepare rebuttal testimony and to allow all parties 30 days for opening briefs.⁴ (San Gabriel Comments, pp, 5-6.) San Gabriel argues that there is ample room to expand the schedule without extending the overall 14-month time frame. What San Gabriel has not considered is that expanding the schedule will result in scheduling problems for ORA staff. Under the current schedule for single district filers, hearings occur during the week that the next round of proposed applications are filed. This schedule thus provides staff time to prepare for hearings and engage in settlement discussions before they begin reviewing the next rounds of applications for deficiencies. However, under San Gabriel’s proposal, hearings will occur approximately two weeks after the next round of proposed applications are filed. Thus ORA staff would not be available to review those new applications

⁴ ORA notes that while San Gabriel argues that it need more than 10 days to prepare rebuttal testimony, the schedule in the workshop report allows the utilities 15 days to prepare rebuttal testimony.

for deficiencies because they would be busy preparing for hearings or participating in settlement negotiations.

The parties worked long and hard to develop the schedule proposed in the workshop report. This schedule was changed from the DD to allow the utilities five additional days to prepare their rebuttal testimony. The Commission should adopt the schedule contained in the workshop report.

IX. CONCLUSION

As stated in its opening comments, ORA recommends that the Commission adopt the draft decision as modified in its opening comments and adopt the portions of the workshop report where a consensus was reached. ORA further recommends that the Commission review the entire rate case plan in two years as it is possible and even likely that issues concerning the adopted plan will arise during the next two years.

Respectfully submitted,

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April 14, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document
**“REPLY COMMENTS OF THE OFFICE OF RATEPAYER ADVOCATES ON
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Executed in San Francisco, California, on the **14th** day of **April, 2004**.

Martha Perez